

c2

Student: _____

1. Financial markets are used for trading:

- A. Both real assets and financial assets.
- B. The goods and services produced by a firm.
- C. Securities, such as shares of IBM.
- D. The raw materials used in manufacturing.

2. Corporations that *do not* issue financial securities such as stock or debt obligations:

- A. Will not be able to increase sales.
- B. Cannot be profitable.
- C. Generate sufficient funds to fulfill their needs.
- D. Do not face double taxation of their profits.

3. The primary distinction between securities sold in the primary and secondary markets is the:

- A. Riskiness of the securities.
- B. Price of the securities.
- C. Previous issuance of the securities.
- D. Profitability of the issuing corporation.

4. When corporations need to raise funds through stock issues, they rely upon the:

- A. Primary market.
- B. Secondary market.
- C. Over-the-counter market.
- D. Centralized NASDAQ exchange.

5. A share of IBM stock is purchased by an individual investor for \$75 and later sold to another investor for \$125. Who profits from this sale?

- A. IBM.
- B. The first investor.
- C. The second investor.
- D. Profit is split between IBM and the investor.

6. Short-term financing decisions commonly occur in the:

- A. Primary markets.
- B. Secondary markets.
- C. Capital markets.
- D. Money markets.

7. A primary market would be utilized when:

- A. Investors buy or sell existing securities.
- B. Shares of common stock are exchanged.
- C. Securities are initially issued.
- D. A commission must be paid on the transaction.

8. Primary markets can be distinguished from secondary markets in that primary markets sell:

- A. Lower valued shares.
- B. Previously unsold shares.
- C. Only the shares of large firms.
- D. Shares with greater profit potential.

9. Which of the following financial assets might be least likely to have an active secondary market?

- A. Common stock of a large firm
- B. Bank loans made to smaller firms
- C. Bonds of a major, multinational corporation
- D. Debt issued by the United States Treasury

10. When Patricia sells her General Motors common stock at the same time that Brian purchases the same amount of General Motors stock, General Motors receives:

- A. The dollar value of the transaction.
- B. The dollar amount of the transaction, less brokerage fees.
- C. Only the par value of the common stock.
- D. Nothing.

11. Which of the following financial markets is not located in one, centralized location?

- A. TSX
- B. CDNX
- C. NASDAQ
- D. AT&T

12. Corporate debt instruments are most commonly traded in the:

- A. TSX
- B. Money market.
- C. Over-the-counter market.
- D. Corporation's headquarters.

13. Which of the following financial intermediaries has shown a preference for investing in *long-term* financial assets?

- A. Commercial banks
- B. Insurance companies
- C. Finance companies
- D. Savings-and-loan associations

14. Which of the following is not typically considered a function of financial intermediaries?

- A. Providing a payment mechanism
- B. Investing in real assets
- C. Accumulating funds from smaller investors
- D. Spreading, or pooling risk among individuals

15. An example of how financial intermediaries can assist in shifting an individual's consumption to the future is:

- A. Lending money to the individual.
- B. Providing a checking account.
- C. Opening a savings account.
- D. Requiring purchases to be in cash.

16. Which of the following financial markets is located in one, centralized location?

- A. TSX.
- B. NASDAQ.
- C. Over-the-counter market.
- D. European Monetary Union.

17. One reason suggesting that banks may be better than individuals at matching lenders to borrowers is that banks:

- A. Can shift loan risk to their deposit customers.
- B. Are motivated by the potential for profit.
- C. Do not have any income tax liability.
- D. Have information to evaluate creditworthiness.

18. Which of the following mutual funds has a tax advantage?

- A. Balanced funds.
- B. Pension funds.
- C. Bond funds.
- D. Funds that invest in foreign countries.

19. A financial institution:

- A. Is a kind of financial intermediary.
- B. Simply pools and invests savings.
- C. raises financing by selling shares or policies.
- D. Invests primarily in securities.

20. Banks cover the costs of the service they provide primarily via:

- A. A management fee.
- B. A service charge.
- C. An interest rate differential.
- D. An operating fee.

21. Which of the following financial intermediaries can loan money directly to businesses?

- A. Mutual funds
- B. Pension funds
- C. Insurance companies
- D. Mutual funds, pension funds, and insurance companies.

22. An example of how financial intermediaries can assist in shifting an individual's consumption forward in time is:

- A. Providing a line of credit.
- B. Opening a passbook account.
- C. Starting a life insurance policy.
- D. Investing in an index fund.

23. Which of the following is least liquid?

- A. Foreign currency.
- B. U.S. Treasury bonds.
- C. Rare coins.
- D. Savings deposit.

24. Which of the following functions does not require financial markets?

- A. Transporting cash across time.
- B. Provision of liquidity.
- C. Risk reduction by investment in diversified portfolios.
- D. Provision of trade information.

25. Liquidity is important to a mutual fund because:

- A. A fund that is more liquid will attract more investors.
- B. The fund's shareholders may want to redeem their shares at any time.
- C. The fund's managers need liquidity to trade actively.
- D. The fund needs to distribute payouts to its shareholders and managers periodically.

26. for the consumer, a credit card:

- A. Transports money forward in time.
- B. Provides liquidity.
- C. Is a convenient way to pay?
- D. Is both (a) and (b)

27. Which of the following actions does *not* help to reduce risk?

- A. Extending the service warranty for your notebook.
- B. Converting your money market account into a mutual fund account.
- C. Contracting to sell your farm produce to the neighborhood grocery.
- D. Buying Japanese yen now when you plan to study in Japan next year.

28. Property insurance companies protect themselves against the extensive damage caused by hurricanes and earthquakes by:

- A. Selling thousands of policies to different homeowners.
- B. Factoring the cost into the price of the policies.
- C. Buying reinsurance against such catastrophes.
- D. Declaring bankruptcy when the need arises.

29. Which of the following information is not provided by the financial markets?

- A. The price of six ounces of gold.
- B. The cost of borrowing \$500,000 for five years.
- C. Microsoft's earnings in 2002.
- D. The cost of wiring one million yen to Japan.

30. A capital investment that generates a 10 percent rate of return is worthwhile if:

- A. Corporate bonds of similar risk offer 8 percent rates of return.
- B. Corporate bonds of similar risk offer 10 percent rates of return.
- C. top-quality corporate bonds offer 10 percent rates of return.
- D. The expected rate of return on the stock market is 12 percent.

31. The cost of capital:

- A. Is the expected rate of return on capital investment
- B. Is an opportunity cost determined by the risk-free rate of return.
- C. Is the interest rate that the firm pays on a loan from a bank or insurance company.
- D. For risky investments is normally higher than the firm's borrowing rate.

32. Excess cash held by a firm should be:

- A. Reinvested by the firm in projects offering the highest rate of return.
- B. Reinvested by the firm in projects offering rates of return higher than the cost of capital.
- C. Reinvested by the firm in the financial markets.
- D. Distributed to shareholders in the form of dividends.

33. The opportunity cost of capital for a safe investment is:

- A. The rate of return on U.S. Treasury notes.
- B. The expected rate of return on the stock market.
- C. The interest rate that the firm pays on a loan from a bank or insurance company.
- D. The interest rate that the firm receives on its checking account.

34. The opportunity cost of capital:

- A. Is the same for all projects requiring the same amount of capital investment.
- B. Is the same for all the projects of a particular firm.
- C. Is the same for all firms that undertake a particular project.
- D. Is the same at all times for a particular project.

35. Suppose Cryogenic Concepts expects a 10 percent return on a new product investment, when top-quality corporate bonds are also offering 10 percent rates of return. What should the firm do?

- A. Invest in the new product.
- B. Invest in the top-quality corporate bonds.
- C. Pay out cash to its shareholders.
- D. Either (a) or (b).

36. An IPO is an acronym that stands for:

- A. Immediate Price Offering
- B. International Public Office
- C. Initial Price Order
- D. Initial Public Offering

37. A Seasoned Equity Offering refers to companies:

- A. Offering new securities after their IPO
- B. Offering new securities each season
- C. Testing whether there is a market for the shares
- D. Delisting certain amount of their stock

38. A private equity fund is a financial intermediary that

- A. Invests in the equity of private businesses
- B. Provide financing and help nurture mature and troubled companies
- C. Both A & C
- D. Does not have the same need for financial disclosure

39. IPOs for smaller corporations are sold in secondary markets.

True False

40. A financial market is where securities are issued and traded.

True False

41. As corporations grow, their requirements for outside capital can expand dramatically.

True False

42. An IPO is not the only occasion on which newly issued stock is sold to the public.

True False

43. Cash retained and reinvested in the firm's operations is cash saved and invested on behalf of the firm's shareholders.

True False

44. A new issue of securities increases both the amount of cash held by the company and the amount of stocks or bonds held by the public.
True False
45. Most trading in the shares of large Canadian corporations takes place on stock exchanges such as the Toronto Stock Exchange (TSX)
True False
46. Larger Canadian companies having sizable global operations, such as Alcan or Canadian Imperial Bank of Commerce, tend to be cross-listed on the TSX as well as other large international exchanges such as New York Stock Exchange (NYSE)
True False
47. Mutual fund managers also try their best to generate superior performance by finding the stock with better than average returns.
True False
48. Financial intermediaries are the same as manufacturing corporations, because they raise their funds in the same manner.
True False
49. Financial markets and intermediaries do not allow investors and businesses to reduce and reallocate risk.
True False
50. Markets and intermediaries do not provide liquidity, that is, the ability to turn an investment back into cash when needed.
True False
51. Financial managers do not look to financial markets to measure or estimate the cost of capital.
True False

52. The cost of capital for corporate investment is set by the rates of return on investment opportunities in financial markets.

True False

53. The opportunity cost of capital is generally not the interest rate that the firm pays on a loan from a bank or insurance company.

True False

54. Why are secondary market transactions of importance to corporations?

55. What are the key advantages of mutual funds and pension funds?

56. What are the functions of financial markets?

57. Do financial institutions have different functions? Explain.

58. How can an individual save and invest in a corporation?

59. Why are secondary market transactions of importance to corporations?

60. What is meant by over-the-counter trading?

61. Why do non-financial corporations need modern financial markets and institutions?

62. Why is there a need for a company to issue shares after its IPO? What are some implications of this?

63. Explain the function of a hedge fund and some of the strategies it uses to maximize wealth.

64. Provide five functions of financial markets and intermediaries

65. Discuss four types of information is provided by financial institutions provide

c2 Key

1. Financial markets are used for trading:
- A. Both real assets and financial assets.
 - B. The goods and services produced by a firm.
 - C. Securities, such as shares of IBM.
 - D. The raw materials used in manufacturing.

Brealey - Chapter 02 #1
Difficulty: Medium
Learning Objective: 2.1
Type: Multiple Choice

2. Corporations that *do not* issue financial securities such as stock or debt obligations:
- A. Will not be able to increase sales.
 - B. Cannot be profitable.
 - C. Generate sufficient funds to fulfill their needs.
 - D. Do not face double taxation of their profits.

Brealey - Chapter 02 #2
Difficulty: Medium
Learning Objective: 2.1
Type: Multiple Choice

3. The primary distinction between securities sold in the primary and secondary markets is the:
- A. Riskiness of the securities.
 - B. Price of the securities.
 - C. Previous issuance of the securities.
 - D. Profitability of the issuing corporation.

Brealey - Chapter 02 #3
Difficulty: Medium
Learning Objective: 2.1
Type: Multiple Choice

4. When corporations need to raise funds through stock issues, they rely upon the:

- A.** Primary market.
- B. Secondary market.
- C. Over-the-counter market.
- D. Centralized NASDAQ exchange.

Brealey - Chapter 02 #4

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

5. A share of IBM stock is purchased by an individual investor for \$75 and later sold to another investor for \$125. Who profits from this sale?

- A. IBM.
- B.** The first investor.
- C. The second investor.
- D. Profit is split between IBM and the investor.

Brealey - Chapter 02 #5

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

6. Short-term financing decisions commonly occur in the:

- A. Primary markets.
- B. Secondary markets.
- C. Capital markets.
- D.** Money markets.

Brealey - Chapter 02 #6

Difficulty: Easy

Learning Objective: 2.1

Type: Multiple Choice

7. A primary market would be utilized when:

- A. Investors buy or sell existing securities.
- B. Shares of common stock are exchanged.
- C.** Securities are initially issued.
- D. A commission must be paid on the transaction.

Brealey - Chapter 02 #7

Difficulty: Easy

Learning Objective: 2.1

Type: Multiple Choice

8. Primary markets can be distinguished from secondary markets in that primary markets sell:

- A. Lower valued shares.
- B. Previously unsold shares.**
- C. Only the shares of large firms.
- D. Shares with greater profit potential.

Brealey - Chapter 02 #8

Difficulty: Easy

Learning Objective: 2.1

Type: Multiple Choice

9. Which of the following financial assets might be least likely to have an active secondary market?

- A. Common stock of a large firm
- B. Bank loans made to smaller firms**
- C. Bonds of a major, multinational corporation
- D. Debt issued by the United States Treasury

Brealey - Chapter 02 #9

Difficulty: Hard

Learning Objective: 2.1

Type: Multiple Choice

10. When Patricia sells her General Motors common stock at the same time that Brian purchases the same amount of General Motors stock, General Motors receives:

- A. The dollar value of the transaction.
- B. The dollar amount of the transaction, less brokerage fees.
- C. Only the par value of the common stock.
- D. Nothing.**

Brealey - Chapter 02 #10

Difficulty: Hard

Learning Objective: 2.1

Type: Multiple Choice

11. Which of the following financial markets is not located in one, centralized location?

- A. TSX
- B. CDNX
- C. NASDAQ**
- D. AT&T

Brealey - Chapter 02 #11

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

12. Corporate debt instruments are most commonly traded in the:

- A. TSX
- B. Money market.
- C. Over-the-counter market.**
- D. Corporation's headquarters.

Brealey - Chapter 02 #12

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

13. Which of the following financial intermediaries has shown a preference for investing in *long-term* financial assets?

- A. Commercial banks
- B. Insurance companies**
- C. Finance companies
- D. Savings-and-loan associations

Brealey - Chapter 02 #13

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

14. Which of the following is not typically considered a function of financial intermediaries?

- A. Providing a payment mechanism
- B. Investing in real assets**
- C. Accumulating funds from smaller investors
- D. Spreading, or pooling risk among individuals

Brealey - Chapter 02 #14

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

15. An example of how financial intermediaries can assist in shifting an individual's consumption to the future is:

- A. Lending money to the individual.
- B. Providing a checking account.
- C. Opening a savings account.**
- D. Requiring purchases to be in cash.

Brealey - Chapter 02 #15

Difficulty: Hard

Learning Objective: 2.2

Type: Multiple Choice

16. Which of the following financial markets is located in one, centralized location?

- A.** TSX.
- B. NASDAQ.
- C. Over-the-counter market.
- D. European Monetary Union.

Brealey - Chapter 02 #16

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

17. One reason suggesting that banks may be better than individuals at matching lenders to borrowers is that banks:

- A. Can shift loan risk to their deposit customers.
- B. Are motivated by the potential for profit.
- C. Do not have any income tax liability.
- D.** Have information to evaluate creditworthiness.

Brealey - Chapter 02 #17

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

18. Which of the following mutual funds has a tax advantage?

- A. Balanced funds.
- B.** Pension funds.
- C. Bond funds.
- D. Funds that invest in foreign countries.

Brealey - Chapter 02 #18

Difficulty: Medium

Learning Objective: 2.3

Type: Multiple Choice

19. A financial institution:

- A.** Is a kind of financial intermediary.
- B. Simply pools and invests savings.
- C. raises financing by selling shares or policies.
- D. Invests primarily in securities.

Brealey - Chapter 02 #19

Difficulty: Hard

Learning Objective: 2.2

Type: Multiple Choice

20. Banks cover the costs of the service they provide primarily via:

- A. A management fee.
- B. A service charge.
- C. An interest rate differential.**
- D. An operating fee.

Brealey - Chapter 02 #20

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

21. Which of the following financial intermediaries can loan money directly to businesses?

- A. Mutual funds
- B. Pension funds
- C. Insurance companies**
- D. Mutual funds, pension funds, and insurance companies.

Brealey - Chapter 02 #21

Difficulty: Easy

Learning Objective: 2.2

Type: Multiple Choice

22. An example of how financial intermediaries can assist in shifting an individual's consumption forward in time is:

- A. Providing a line of credit.**
- B. Opening a passbook account.
- C. Starting a life insurance policy.
- D. Investing in an index fund.

Brealey - Chapter 02 #22

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

23. Which of the following is least liquid?

- A. Foreign currency.
- B. U.S. Treasury bonds.
- C. Rare coins.**
- D. Savings deposit.

Brealey - Chapter 02 #23

Difficulty: Medium

Learning Objective: 2.3

Type: Multiple Choice

24. Which of the following functions does not require financial markets?

- A.** Transporting cash across time.
- B. Provision of liquidity.
- C. Risk reduction by investment in diversified portfolios.
- D. Provision of trade information.

Brealey - Chapter 02 #24

Difficulty: Medium

Learning Objective: 2.3

Type: Multiple Choice

25. Liquidity is important to a mutual fund because:

- A. A fund that is more liquid will attract more investors.
- B.** The fund's shareholders may want to redeem their shares at any time.
- C. The fund's managers need liquidity to trade actively.
- D. The fund needs to distribute payouts to its shareholders and managers periodically.

Brealey - Chapter 02 #25

Difficulty: Hard

Learning Objective: 2.3

Type: Multiple Choice

26. for the consumer, a credit card:

- A. Transports money forward in time.
- B. Provides liquidity.
- C.** Is a convenient way to pay?
- D. Is both (a) and (b)

Brealey - Chapter 02 #26

Difficulty: Medium

Learning Objective: 2.3

Type: Multiple Choice

27. Which of the following actions does *not* help to reduce risk?

- A. Extending the service warranty for your notebook.
- B.** Converting your money market account into a mutual fund account.
- C. Contracting to sell your farm produce to the neighborhood grocery.
- D. Buying Japanese yen now when you plan to study in Japan next year.

Brealey - Chapter 02 #27

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

28. Property insurance companies protect themselves against the extensive damage caused by hurricanes and earthquakes by:

- A. Selling thousands of policies to different homeowners.
- B. Factoring the cost into the price of the policies.
- C. Buying reinsurance against such catastrophes.
- D. Declaring bankruptcy when the need arises.

Brealey - Chapter 02 #28
Difficulty: Medium
Learning Objective: 2.2
Type: Multiple Choice

29. Which of the following information is not provided by the financial markets?

- A. The price of six ounces of gold.
- B. The cost of borrowing \$500,000 for five years.
- C. Microsoft's earnings in 2002.
- D. The cost of wiring one million yen to Japan.

Brealey - Chapter 02 #29
Difficulty: Medium
Learning Objective: 2.1
Type: Multiple Choice

30. A capital investment that generates a 10 percent rate of return is worthwhile if:

- A. Corporate bonds of similar risk offer 8 percent rates of return.
- B. Corporate bonds of similar risk offer 10 percent rates of return.
- C. top-quality corporate bonds offer 10 percent rates of return.
- D. The expected rate of return on the stock market is 12 percent.

Brealey - Chapter 02 #30
Difficulty: Easy
Learning Objective: 2.4
Type: Multiple Choice

31. The cost of capital:

- A. Is the expected rate of return on capital investment
- B. Is an opportunity cost determined by the risk-free rate of return.
- C. Is the interest rate that the firm pays on a loan from a bank or insurance company.
- D. For risky investments is normally higher than the firm's borrowing rate.

Brealey - Chapter 02 #31
Difficulty: Hard
Learning Objective: 2.4
Type: Multiple Choice

32. Excess cash held by a firm should be:

- A. Reinvested by the firm in projects offering the highest rate of return.
- B.** Reinvested by the firm in projects offering rates of return higher than the cost of capital.
- C. Reinvested by the firm in the financial markets.
- D. Distributed to shareholders in the form of dividends.

Brealey - Chapter 02 #32

Difficulty: Medium

Learning Objective: 2.4

Type: Multiple Choice

33. The opportunity cost of capital for a safe investment is:

- A.** The rate of return on U.S. Treasury notes.
- B. The expected rate of return on the stock market.
- C. The interest rate that the firm pays on a loan from a bank or insurance company.
- D. The interest rate that the firm receives on its checking account.

Brealey - Chapter 02 #33

Difficulty: Medium

Learning Objective: 2.4

Type: Multiple Choice

34. The opportunity cost of capital:

- A. Is the same for all projects requiring the same amount of capital investment.
- B. Is the same for all the projects of a particular firm.
- C.** Is the same for all firms that undertake a particular project.
- D. Is the same at all times for a particular project.

Brealey - Chapter 02 #34

Difficulty: Hard

Learning Objective: 2.4

Type: Multiple Choice

35. Suppose Cryogenic Concepts expects a 10 percent return on a new product investment, when top-quality corporate bonds are also offering 10 percent rates of return. What should the firm do?

- A. Invest in the new product.
- B. Invest in the top-quality corporate bonds.
- C.** Pay out cash to its shareholders.
- D. Either (a) or (b).

Brealey - Chapter 02 #35

Difficulty: Medium

Learning Objective: 2.4

Type: Multiple Choice

36. An IPO is an acronym that stands for:

- A. Immediate Price Offering
- B. International Public Office
- C. Initial Price Order
- D.** Initial Public Offering

Brealey - Chapter 02 #36

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

37. A Seasoned Equity Offering refers to companies:

- A.** Offering new securities after their IPO
- B. Offering new securities each season
- C. Testing whether there is a market for the shares
- D. Delisting certain amount of their stock

Brealey - Chapter 02 #37

Difficulty: Medium

Learning Objective: 2.1

Type: Multiple Choice

38. A private equity fund is a financial intermediary that

- A. Invests in the equity of private businesses
- B. Provide financing and help nurture mature and troubled companies
- C.** Both A & C
- D. Does not have the same need for financial disclosure

Brealey - Chapter 02 #38

Difficulty: Medium

Learning Objective: 2.2

Type: Multiple Choice

39. IPOs for smaller corporations are sold in secondary markets.

FALSE

Brealey - Chapter 02 #39

Difficulty: Medium

Learning Objective: 2.1

Type: True False

40. A financial market is where securities are issued and traded.

TRUE

Brealey - Chapter 02 #40

Difficulty: Easy

Learning Objective: 2.1

Type: True False

41. As corporations grow, their requirements for outside capital can expand dramatically.

TRUE

Brealey - Chapter 02 #41

Difficulty: Medium

Learning Objective: 2.1

Type: True False

42. An IPO is not the only occasion on which newly issued stock is sold to the public.

TRUE

Brealey - Chapter 02 #42

Difficulty: Medium

Learning Objective: 2.1

Type: True False

43. Cash retained and reinvested in the firm's operations is cash saved and invested on behalf of the firm's shareholders.

TRUE

Brealey - Chapter 02 #43

Difficulty: Easy

Learning Objective: 2.1

Type: True False

44. A new issue of securities increases both the amount of cash held by the company and the amount of stocks or bonds held by the public.

TRUE

Brealey - Chapter 02 #44

Difficulty: Easy

Learning Objective: 2.1

Type: True False

45. Most trading in the shares of large Canadian corporations takes place on stock exchanges such as the Toronto Stock Exchange (TSX)

TRUE

Brealey - Chapter 02 #45

Difficulty: Easy

Learning Objective: 2.1

Type: True False

46. Larger Canadian companies having sizable global operations, such as Alcan or Canadian Imperial Bank of Commerce, tend to be cross-listed on the TSX as well as other large international exchanges such as New York Stock Exchange (NYSE)

TRUE

Brealey - Chapter 02 #46

Difficulty: Medium

Learning Objective: 2.1

Type: True False

47. Mutual fund managers also try their best to generate superior performance by finding the stock with better than average returns.

TRUE

Brealey - Chapter 02 #47

Difficulty: Medium

Learning Objective: 2.1

Type: True False

48. Financial intermediaries are the same as manufacturing corporations, because they raise their funds in the same manner.

FALSE

Brealey - Chapter 02 #48

Difficulty: Medium

Learning Objective: 2.2

Type: True False

49. Financial markets and intermediaries do not allow investors and businesses to reduce and reallocate risk.

FALSE

Brealey - Chapter 02 #49

Difficulty: Hard

Learning Objective: 2.2

Type: True False

50. Markets and intermediaries do not provide liquidity, that is, the ability to turn an investment back into cash when needed.

FALSE

Brealey - Chapter 02 #50

Difficulty: Hard

Learning Objective: 2.2

Type: True False

51. Financial managers do not look to financial markets to measure or estimate the cost of capital.

FALSE

Brealey - Chapter 02 #51

Difficulty: Medium

Learning Objective: 2.2

Type: True False

52. The cost of capital for corporate investment is set by the rates of return on investment opportunities in financial markets.

TRUE

Brealey - Chapter 02 #52

Difficulty: Medium

Learning Objective: 2.4

Type: True False

53. The opportunity cost of capital is generally not the interest rate that the firm pays on a loan from a bank or insurance company.

TRUE

Brealey - Chapter 02 #53

Difficulty: Easy

Learning Objective: 2.4

Type: True False

54. Why are secondary market transactions of importance to corporations?

Although corporations do not generate cash flows from secondary market transactions (other than those they initiate), it is the existence of secondary markets that made many investors comfortable enough to invest in their primary market offerings. In other words, if investors felt there would not be an organized, convenient market in which to alter their portfolio of securities, their original investment decisions might be quite different. Also, the secondary market acts as a form of "scorecard" for the decisions of management and the general prospects of the firm. Market values are, in most instances, much more important than book values, thus values in the secondary market give investors and analysts alike the ability to evaluate a firm. These evaluations will also affect future primary market offerings.

Brealey - Chapter 02 #54

Difficulty: Easy

Learning Objective: 2.1

Type: Short Answer

55. What are the key advantages of mutual funds and pension funds?

Mutual and Pension funds allow investors to diversify in professionally managed portfolios. Pension funds offer an additional tax advantage, because the returns on pension investments are not taxed until withdrawn from the plan.

Brealey - Chapter 02 #55

Difficulty: Easy

Learning Objective: 2.2

Type: Short Answer

56. What are the functions of financial markets?

Financial markets help channel savings to corporate investment, and they help match up borrowers and lenders. They provide liquidity and diversification opportunities for investors. Trading in financial markets provides a wealth of useful information for the financial manager.

Brealey - Chapter 02 #56

Difficulty: Easy

Learning Objective: 2.1

Type: Short Answer

57. Do financial institutions have different functions? Explain.

Financial institutions carry out a number of similar functions but in different ways. They channel savings to corporate investment, and they serve as intermediaries between lenders and borrowers. Banks also provide liquidity for depositors and, of course, play a special role in the economy's payments systems. Insurance companies allow policyholders to pool risks.

Brealey - Chapter 02 #57
Difficulty: Medium
Learning Objective: 2.1
Type: Short Answer

58. How can an individual save and invest in a corporation?

Households and foreign investors provide most of the savings for corporate financing; financial markets and institutions provide the process and contracts to channel funds from savers to corporations (financial investment) for real investment. Figures 2-1 and 2-2 are excellent graphics for this discussion. Individuals can save and invest in a corporation by lending to, or buying shares in, the financial markets or a financial intermediary such as a bank or mutual fund that subsequently invests in the corporation. When the corporation retains cash and reinvests in the firm's operations, that cash is saved and invested on behalf of the firm's shareholders. The reinvested cash could have been paid out to the shareholders. By not taking the cash, these investors have also reinvested their savings in the corporation.

Brealey - Chapter 02 #58
Difficulty: Easy
Learning Objective: 2.1
Type: Short Answer

59. Why are secondary market transactions of importance to corporations?

Although corporations do not generate cash flows from secondary market transactions (other than those they initiate), it is the existence of secondary markets that made many investors comfortable enough to invest in their primary market offerings. In other words, if investors felt there would not be an organized, convenient market in which to alter their portfolio of securities, their original investment decisions might be quite different. Also, the secondary market acts as a form of "scorecard" for the decisions of management and the general prospects of the firm. Market values are, in most instances, much more important than book values, thus values in the secondary market give investors and analysts alike the ability to evaluate a firm. These evaluations will also affect future primary market offerings.

Brealey - Chapter 02 #59
Difficulty: Easy
Learning Objective: 2.1
Type: Short Answer

60. What is meant by over-the-counter trading?

"Over-the-counter" refers to trading that does not take place on a centralized exchange such as the New York Stock Exchange. Trading of securities on NASDAQ is over-the-counter, because NASDAQ is a network of security dealers linked by computers. Although some corporate bonds are traded on the New York Stock Exchange, most corporate bonds are traded over-the-counter, as are all U.S. Treasury securities. Foreign exchange trading is also over-the-counter.

Brealey - Chapter 02 #60
Difficulty: Easy
Learning Objective: 2.1
Type: Short Answer

61. Why do non-financial corporations need modern financial markets and institutions?

The reason is that corporations need access to financing in order to innovate and grow. A modern financial system offers different types of financing, depending on a corporation's age and the nature of its business. A high-tech start-up will seek venture-capital financing, for example. A mature firm will rely more on bond markets.

Brealey - Chapter 02 #61
Difficulty: Medium
Learning Objective: 2.2
Type: Short Answer

62. Why is there a need for a company to issue shares after its IPO? What are some implications of this?

An IPO is not the only occasion on which newly issued stock is sold to the public. Established firms also issue new shares from time to time. Each new issue of shares increases both the amount of cash held by the company and the number of shares held by the public. However, investors do not like new issues of security, as it means issues of dilution.

Brealey - Chapter 02 #62
Difficulty: Medium
Learning Objective: 2.1
Type: Short Answer

63. Explain the function of a hedge fund and some of the strategies it uses to maximize wealth.

Like mutual funds, these receive money from investors and then invest in a portfolio of securities. But they differ from mutual funds in at least two ways. First, because hedge funds usually follow complex, high-risk investment strategies, access is restricted to knowledgeable investors such as pension funds, endowment funds, and wealthy individuals. The hedge fund is not in the "retail" investment business. Second, hedge funds try to attract the most talented managers by compensating them with potentially lucrative, performance-related fees. In contrast, mutual funds usually pay a fixed percentage of assets under management. Hedge funds follow many different investment strategies that may not generally be available to traditional mutual funds such as taking both long and short positions in stocks and using arbitrage, leverage, options, futures, bonds, and other financial instruments to capitalize on market conditions.

Brealey - Chapter 02 #63
Difficulty: Medium
Learning Objective: 2.2
Type: Short Answer

64. Provide five functions of financial markets and intermediaries

Transport cash across time; Risk transfer and diversification; Liquidity; Payment mechanism; Provides information

Brealey - Chapter 02 #64
Difficulty: Medium
Learning Objective: 2.3
Type: Short Answer

65. Discuss four types of information is provided by financial institutions provide

In a well-functioning market, transparent information can be found for: commodity prices; interest rates; company and stocks.

Brealey - Chapter 02 #65
Difficulty: Medium
Learning Objective: 2.3
Type: Short Answer

c2 Summary

<u>Category</u>	<u># of Questions</u>
Brealey - Chapter 02	65
Difficulty: Easy	16
Difficulty: Hard	9
Difficulty: Medium	40
Learning Objective: 2.1	32
Learning Objective: 2.2	18
Learning Objective: 2.3	7
Learning Objective: 2.4	8
Type: Multiple Choice	38
Type: Short Answer	12
Type: True False	15